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Business and Economic Conditions

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General Business Conditions

THE new year has brought few, if any, signs of the hoped-for business pickup. In both industry and trade buying policy remains cautious, to hold down inventories and reduce them where possible. To be sure, inventory positions and prospects vary from line to line. It is generally conceded that steel inventories must be approximately at bottom. Thus, steel operations should hold up or improve. On the other hand, automobile dealers have more than one million cars on hand. There is no precipitate rush to cut this stock down, this early in the year, but the situation restrains current production. Further cuts have been announced in passenger car assembly schedules. Between these extremes, individual industries are working out their own adjustments.

During a period of general inventory reduction, goods are sold off the shelves and out of warehouses without replacement. Even though final demand is maintained at a high level, manufacturing output and employment are curtailed.

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Industrial production, as measured by the seasonally adjusted Federal Reserve index (1957 = 100), dipped to 103 in December, down from 105 in November and the peak of 111 in January 1960. The slowdown in production, centered initially in basic materials, has spread to consumer goods and business capital goods. A lull continues in home building. But F. W. Dodge officials report an upsurge of contract-letting for schools, highways, and other heavy construction, which will help provide an offset to declining tendencies in other lines of business.

The usual Christmas job increase in retail stores and post offices was largely offset by cutbacks of roughly 300,000 persons each in construction and manufacturing. Only part of these layoffs could be attributed to seasonal influences and unusually bad weather in mid-December. Government statisticians figure that the number of persons out of work in December rose to 4,540,000, equivalent to 6.8 per cent of the labor force on a seasonally adjusted basis. Secretary of Labor Arthur Goldberg has estimated that 5½ million were unemployed in January; if correct, this would be the highest number for any month since Pearl Harbor. Part of the January rise in unemployment resulted from layoffs of workers hired for the Christmas season, while inventory-taking and curtailment of outdoor activities usually cause other layoffs at this time of year.

The decline in factory employment, which has been under way since March, began to be reflected in over-all personal income in November and December. Retail sales have also felt the effects of payroll cuts; even though December sales were 5 per cent higher than last Christmas, the increase over November was smaller than usual. In January, stormy weather again hurt retailers. New car sales, January 1-20, were off 18 per cent from a year earlier, while department stores sold 3 per cent less in the first three weeks than in the same weeks of 1960.

Strength of Final Demand

Probably the most promising indication that the current business dip will be relatively mild, over all, is the fact that the gross national product (GNP) has been well sustained, at least through the end of 1960. According to preliminary estimates in the President's Economic Report, GNP held within a very narrow range throughout 1960. In the fourth quarter, it was at a seasonally adjusted annual rate of $503.5 billion, only three tenths of one per cent below the record second quarter rate of $505 billion. If the influence of inventory changes is removed from the calculations, it becomes apparent that final demand gained steadily all year long – to a new peak rate of $507.5 billion in the fourth quarter, up $17.6 billion since the first quarter of 1960.

Most major areas of the economy had the benefit of sustained final demand. The fourth quarter estimates included new records for consumer expenditures and government spending. The surplus of exports of goods and services was the largest since the Suez crisis. Business fixed investment remained close to the third quarter peak. The only marked lag was in residential construction expenditures, which were 12 per cent below the record peak reached in the second quarter of 1959.

This leaves the shift in inventory demand as primarily responsible for the lag in GNP. During the first quarter of 1960, business was rebuilding steel stocks and otherwise accumulating inventories at the rate of $11.4 billion a year. But, with the evaporation of inflationary psychology, and disappointing sales and profits, this phase quickly gave way to one of careful policing of inventory positions. We had a $4 billion annual rate of liquidation by the fourth quarter. Altogether, the rate of inventory demand was reduced more than $15 billion. The fact that a cut of this magnitude has been absorbed with only minor fluctuations in GNP is definitely encouraging. At the same time, the estimate that inventories were cut at a $4 billion rate in the fourth quarter indicates that the process of adjustment is much further advanced than many observers had believed and the low point of the decline should be correspondingly nearer.

Sustained final demand from consumers, business, and government will eventually be the means of turning things around. When businessmen find their stocks are too low to keep production and shipments rolling smoothly, when shortages crop up and delivery schedules show signs of stretching out, then orders will pick up, followed in due course by rising production, shipments, and inventories.

The Samuelson Report

On January 18 President Eisenhower followed up his annual message on the State of the Union with his annual Economic Report which examined more specifically developments in the economy. He expressed confidence that the inventory adjustment was running its course and that restraints on inflation had helped prepare "a solid foundation for a resumption of sustainable growth." He emphasized how rising Government expenditures can "put a direct upward pressure on costs and prices" and also jeopardize possibilities for "selective revision of our tax structure . . . needed to promote incentives. . . ."

President Kennedy did not immediately disclose his economic program. By way of preparation, he had appointed a number of expert "task forces" to develop recommendations on policies in various fields. During January, Mr. Kennedy received reports from task forces dealing with such varied subjects as depressed areas, foreign aid, housing, education, health and welfare, natural resources, food for peace, and the space program. These reports had one common denominator—they commended more federal spending now and for the years ahead.

One of the key task forces, headed by Professor Paul A. Samuelson of the Massachusetts Institute of Technology, dealt with the problem of the budget as a whole and the help that fiscal policies could give to correcting the present business slump and embarking the economy toward "new frontiers". Of most immediate concern, naturally, is the volume of unemployment, criticized as excessive at the 5.1 per cent average level prevailing in the first half of 1960 and, since October, up beyond 6 per cent.

The Samuelson report, entitled "Prospects and Policies for the 1961 American Economy," is notable for its recognition of the realities that confront the new Administration. It shows an appreciation of the complexity of the problem of improving our economic performance while preserving confidence in the dollar as a standard of value at home and abroad. It points out the limitations imposed on our policies by the changed balance-of-payments position of the United States. It directs attention to the policy dilemma created by "cost-push" inflation. It carefully distinguishes the present economic situation from the kind of crisis inherited by President Roosevelt in 1933 and warns against pushing "the panic button."

Dealing with the Recession

The report identifies the business slide since mid-1960 as the fourth postwar "recession" but asserts that, "with proper actions by the Govern-

ment, the contraction . . . can be brought to a halt within 1961 itself and converted into an upturn." Hope is implicit in the report that the economy will turn itself around, and develop a $510-515 billion gross national product this year, without much help beyond that given by the so-called automatic stabilizers. Meanwhile, further increase in unemployment, and decrease in profits, are predicted for early 1961.

No doubt "proper actions by the Government" can not only insure that the contraction will be brought to a halt but also infuse new vigor into a "sluggish and tired economy":

> The goal for 1961 must be to bring the recession to an end, to reinstate a condition of expansion and recovery, and to adopt measures likely to make that expansion one that will not after a year or two peter out at levels of activity far below our true potential.

The problem is, what are these proper actions? "The two principal governmental weapons to combat recession and slackness are fiscal (i.e., tax and expenditure) policy and monetary or credit policy." The report takes the point of view that, while the Federal Reserve should increase the credit supply, the main emphasis should be placed on tax and expenditure policies. A report of the Congressional Joint Economic Committee, a year ago, made the same recommendation, giving as reasons the prompter and larger effects from fiscal actions. The Samuelson group gives as its reason the sensitivity of holders of dollar balances to sharp declines in short-term money rates. The fear is that if yields on Treasury bills fell, say to 1 per cent, while short-term rates remained higher in foreign money markets, holders of dollar assets would shift abroad to take advantage of the better rates. This could increase the gold outflow.

On the expenditure side the report has a ten-point program based on the principle that government expenditures "desired for their own sake should be pushed hard." Defense expenditures should be determined on their own merits and not made "the football of economic stabilization." A high priority is given to increased foreign aid, education, urban renewal, health and welfare, enlarged and prolonged unemployment compensation, acceleration of public works "to the extent feasible without disrupting their orderly execution", speeding highway construction, depressed area programs, and natural resource development projects. It is suggested that total Federal Government outlays be raised roughly $3 billion to $5 billion above already planned programs in fiscal 1962. In other words, against President Eisenhower's $80.9 billion expenditure proposals for fiscal '62, the Samuelson program, described as not involving "the inflationary risks of an all-out anti-recession blitzkrieg", would seem to imply federal budget expenditures at a level around $85 billion.

Cheap Money for Housing

Though no price tag is attached, the report puts great emphasis on needs to stimulate residential housing. Unlike the previous business recessions of 1954 and 1958, home building so far has failed to respond to easier availability of mortgage credit. The reasons are explained:

> Down payments are already quite low, as are monthly payments. Vacancy rates, particularly in certain areas and for certain types of housing, have been rising. The age brackets that provide the greatest demand for new housing are hollow ones because of the dearth of births during the depression of the Nineteen Thirties.

Nonetheless, the report urges, as it were, stockpiling of homes in anticipation of "the need for housing a few years from now when the wartime babies move into the house-buying brackets." To get more homes built, the report recommends that mortgage rates (now upwards of 5½ per cent) "might be brought down to, say, 4½ per cent interest". Experts in the mortgage field find it hard to figure how such a reduction could be accomplished – unless the Federal National Mortgage Association were to buy the mortgages and borrow the money from the Treasury, and then have the Federal Reserve create more money to replenish the Treasury. Such an outright policy of inflation would seem a high price to pay for creating a stock of unoccupied dwellings to deteriorate over the years until more homes are needed.

As for the Federal Reserve, the report suggests that the authorities get farther away from the policy of buying "bills only" and, through purchases of intermediate and long-term U.S. bonds, act to raise their prices and depress their yields. Such a policy, while inviting speculators to buy U.S. bonds for capital gains, would lead genuine investors to sell out in favor of other uses of funds, including mortgage investments. It would constitute a road block to improvement in the structure of the federal debt.

The report lays great stress on needs to prevent short-term money rates from dropping too far because of the fear that a larger gold outflow would be induced. In this whole discussion, it is possible to overemphasize the importance of short-term interest rates. Investors will sometimes move money abroad solely to take advantage of higher money rates in London or elsewhere. But they would be no less sensitive to uncontrolled increases in government expenditure,

or artificial efforts to drive down long-term interest rates to help finance deficits and stimulate home building — unsound measures that might seem to be the prelude to dollar devaluation. The real cure for excessive capital outflow is to encourage growth in the U.S. economy and higher levels of profitability on investments in this country.

"Second Line of Defense"

All the foregoing policy recommendations are founded on the "optimistic" premise that the recession will be mild and followed promptly by an upturn. But Professor Samuelson and his associates warn that this fourth postwar business recession might turn out to be more serious than its predecessors. While the report offers "important warnings" against undertaking "a massive program of hastily devised public works whose primary purpose is merely that of making jobs and getting money pumped into the economy", it urges preparation of a further set of measures as a "second line of defense" against the contingency of a deepening recession with unemployment rising toward and perhaps beyond "the critical 7½ per cent level": "In that case corporate profits will sink far below their present depressed levels, and a sagging stock market may add to . . . pessimism."

Accepting a large deficit as unavoidable and desirable in any prolonged recession, Professor Samuelson specifies only one item for the second line of defense: an across-the-board cut of 3 or 4 percentage points in personal income tax rates to take effect, under the withholding system, in March or April and to continue until the end of the year (perhaps with authorization to the President to extend the cut into 1962). It may be calculated that this proposal would involve the loss of something like $5 billion in tax revenues though, if it were effective in genuinely stimulating the economy, such a revenue loss would never be fully realized. The trouble is that any such measure would be no more than a short-lived prop and would further postpone getting down to brass tacks of permanent income tax rate reform.

On this point it is worth noting the views of the new Secretary of the Treasury, Mr. Douglas Dillon, as expressed before the Senate Finance Committee. While not firmly committing himself, Mr. Dillon seemed to have somewhat different ideas on the tax stimulus needed. Expressing the hope that he could prepare at least a partial program of reform by April 1, he stated: "I would rather have lower rates and fewer loopholes. If action is to be taken, it is a propitious time now, rather than waiting a year or so."

In any case, it is refreshing to see something other than massive make-work projects — which failed to get us out of the Great Depression of the 1930's — offered as an antidote for business slump. One may recall that J. M. Keynes back in 1933 suggested tax relief as an alternative to increased government spending. But this idea was never tried. Indeed, the emphasis on increased spending, and apprehensions over the inflationary consequences of resultant deficits, led to a dreary succession of tax increases which helped to perpetuate the depression.

Curing Economic Anemia

The Samuelson report concerns itself not only with the recession, but also with the more fundamental matter of combatting "the basic sluggishness" of the economy. Calling the 1959-60 recovery "an anemic one", it characterizes the economy as chronically slack, sluggish, and tired, and warns that even a modest recession will leave unemployment as "a grave social problem." Yet the report has no real prescription to cure this economic anemia. There is no clear endorsement of basic income tax rate reform which is, beyond doubt, the most vital action that could be taken to unleash the expansive power of the American economy. What the report says is that:

> At this time it would be urgently important to make sure that any tax cut was clearly a temporary one. With the continued international uncertainty and with new public programs coming up in the years ahead, sound finance may require a maintenance of our present tax structure and any weakening of it in order to fight a recession might be tragic.
>
> Even if it should prove to be the case that growth makes reduction of tax rates possible in the long run, that should be a decision taken on its own merits and adopted along with a comprehensive reforming of our present tax structure. (Various tax devices to stimulate investment might also be part of a comprehensive program designed to eliminate loopholes, promote equity, and enhance incentives.)

The question is whether this argument does not put the cart before the horse. If excessive tax rates repress enterprise, we will never get the growth to permit the rates to be reduced. On the other hand, if tax rate reforms can encourage more rapid growth, then the revenues will increase along with invigorated expansion of private, tax-paying enterprise.

In this context it is heartening to read the task force report on "The Economic Situation and the Balance of Payments" submitted to President Kennedy by a distinguished panel headed by Mr. Allan Sproul. This report goes beyond discussing actions, including budgetary policies, which can protect the dollar and also the free-

dom of people to use their money as they please. It also offers solid advice on the perils of letting government spending rise out of hand. Stating that "emergency spending programs would, in practice, establish a needlessly higher expenditure plateau from which the next increase would occur", the task force favors instead easing taxes but with a "basic budget position . . . under firm control." Endorsement is given to a temporary reduction in tax rates. Moreover:

> Some changes in our tax laws that would be helpful in promoting a vigorously expanding economy should be considered now, without waiting for a complete overhaul of the tax structure. As the economy is thereby strengthened any lost revenue would be recouped through a higher national income.

Standards of Unemployment Compensation

The Samuelson report urges improved unemployment compensation as a most important anti-recession measure. Stress is laid not only on making unemployment easier to bear for the individual but also on getting more money into circulation through the hands of the unemployed:

> . . . unemployment compensation benefits . . . go to those who need them and who will spend the money promptly; they also go up at the right time and in the right place. . . .

The report urges passage of emergency legislation (as in the 1958 business slump) to permit states to continue unemployment benefits for at least 39 weeks, regardless of the condition of their insurance reserves; basic federal standards for unemployment insurance to cover employes in all firms regardless of size; and perhaps varying benefits in such a way that they will go up when unemployment is high and go down when unemployment is low.

This last proposal represents endorsement in principle of Professor John K. Galbraith's idea for a system of Cyclically Graduated Compensation (CGC). In his book, *The Affluent Society*, Professor Galbraith suggests that under conditions of full employment — when unemployment is 2 million or less — CGC would be paid in the amount of say half the difference between standard unemployment compensation and the individual's last wage. When unemployment passed 3 million, the CGC payment would rise to two thirds and perhaps to a top of four fifths of the difference at 4 million. At this point — the position we have been in these last six months — "the worker who earned the average 1956 weekly wage of $80, and who was entitled to a regular (and comparatively generous) payment in that year of $36, would have a total weekly income of $71.20."

There are three essential things that this approach ignores. First, employment involves some personal inconveniences, such as responding to alarm clocks and getting to and from work in fair weather and foul. Second, holding a job involves out-of-pocket expenses, for transportation, meals, proper clothing, union dues, etc.

Finally, the proposal overlooks the fact that unemployment compensation is tax-exempt whereas the worker is subject to withholding taxes which make his "pay" a mythical amount that has no meaning save as a base for calculating deductions and tax liabilities. In New York State, for example, a single man or woman working at $80 a week would find a maximum of $63.80 in his pay envelope. He could get himself a raise of 12 per cent by taking Professor Galbraith's $71.20 a week. If idleness were made so rewarding, it is hard to see how the unemployment rolls could ever be reduced. The problem instead might be to get people to work.

Market-Power Inflation

Professor Samuelson and his colleagues do not ignore the "new malady" of "cost-push" or "market-power" inflation:

> It is important . . . to realize that there are some problems that fiscal and monetary policy cannot themselves come to grips with. Thus, if there is indeed a tendency for prices and wages to rise long before we reach high employment, neither monetary nor fiscal policy can be used to the degree necessary to promote desired growth.

Here, without offering a solution, the report suggests the necessity for "direct attack on the wage-price spiral" and asks the question:

> Will it not be possible to bring government influence to bear on this vital matter without invoking direct controls on wages and prices? . . .
>
> Just as we pioneered in the Nineteen Twenties in creating potent monetary mechanisms and in the Nineteen Thirties in forging the tools of effective fiscal policy, so may it be necessary in the Nineteen Sixties to meet head on the problem of a price creep.
>
> This is a challenge to mixed economies all over the free world, and is not to be met by government alone.

By posing anew this critical problem, the Samuelson group has helped to put the tasks ahead in perspective. If we are to achieve the goals that have been set for the American economy, we must deal effectively with the creeping inflation caused by the steady pressure of rising costs.

The Challenge

President Kennedy, in a speech at Philadelphia three months ago, expressed a philosophy that every American can share:

> I believe in an America that is on the march. . . . If we continue to stand still — if we continue to lie at anchor — if we continue to sit on dead center — if we content ourselves with the easy life and rosy assurances — then the gates will soon be open to a lean and hungry enemy. . . . The kind of America in which we believe lies beyond the new and challenging frontiers on which we now stand. New crises, new demands, new pressures, new problems, new opportunities must all be met before success can be finally realized.

The challenge now is for the new President: to decide where these new frontiers shall lie and where vistas of new opportunities shall be opened. The big question to resolve is whether the way of progress in our "mixed economy" is further to enlarge the role of Government and its surveillance over private decision making, or to enlarge opportunities for individual initiative.

Two eloquent statements point to the right answer, one from the Democratic Party platform, the other from Mr. Eisenhower's final Economic Report. The platform recognized that:

> Free competitive enterprise is the most creative and productive form of economic order that the world has seen.

Mr. Eisenhower enlarged upon the theme:

> In our free economy, economic growth and the improvement of living standards depend not primarily on what government does but mainly on what is done by individuals and groups acting in their private capacities. . . . Government makes its basic economic contribution not through the volume of its own expenditures but by promoting conditions favorable to the exercise of individual initiative and private effort.

The 1962 Federal Budget

Among the final actions of the Eisenhower Administration was the submission to Congress, on January 16, of budget recommendations for the fiscal year ending June 30, 1962. The new budget, which proposes expenditures of $80.9 billion and projects revenues of $82.3 billion, will serve as the starting point for Congressional deliberation during the current legislative session. The expenditure figure — a new peacetime record — would be up $2 billion from the revised figure for fiscal '61, and up $16 billion from fiscal '55, the low point on spending during the Eisenhower Administration. Nevertheless, there are many expectations that the Kennedy Administration will wish to enlarge the total. At least, the many proposals for additional federal spending submitted by task forces support this conclusion.

President Eisenhower tailored his expenditure figures to the revenue estimates with the objective of realizing a sequence of three successive budget surpluses. His most dramatic fiscal achievement, however, was cutting nearly $11 billion out of his predecessor's spending proposal for fiscal '54. This action put the brakes on inflation, permitted the largest tax cut in American history, and re-energized the economy to such an extent that revenues soon reached new peaks and provided $1.6 billion surpluses for debt retirement in fiscal '56 and again in '57. After $15.2 billion of deficit spending in fiscal '58 and '59, President Eisenhower retrenched spending in the fiscal year ended last June and redeveloped a $1.2 billion surplus.

Now the question arises as to what the new business recession will do to the budget. Will we try to spend our way out, as in 1958? Or can we find a formula of stimulation to enterprise that can get a better result at a lesser price?

Federal Budget Expenditures and Receipts
(In Billions of Dollars)

Fiscal year	Expenditures	Receipts	Deficit (—) or Surplus (+)
1958	$71.4	$68.6	— 2.8
1959	80.3	67.9	—12.4
1960	76.5	77.8	+ 1.2
1961 Estimated	78.9	79.0	+ 0.1
1962 Proposed	80.9	82.3	+ 1.5

Despite the business recession, total budget receipts are estimated at record figures of $79.0 billion for fiscal '61 and $82.3 billion for fiscal '62. A year ago, on the basis of a rosier business outlook, an even higher revenue estimate had raised hopes of a $4 billion surplus in fiscal '61.

Revenue projection is a hazardous task, depending as it does on forecasts of the volume of business, profits, and payrolls. The new budget assumes that pre-tax corporate profits will pick up from $45 billion in calendar 1960 to $46 billion this year, and that personal income will advance from $404 billion to $415 billion. If these targets are realized, individual income taxes would yield $45.5 billion, while the corporate tax take would amount to $20.9 billion.

Defense Outlays Enlarged

The budget proposes an increase of $1.4 billion in defense spending to a new peacetime high of $42.9 billion during fiscal '62. Total expenditures for Major National Security (including $2.7 billion for atomic energy and $1.8 billion for military assistance to allied forces) are projected at $47.4 billion in fiscal '62 against $45.9 billion for the current year.

In light of the balance-of-payments problem, Congress no doubt will give special attention to overseas spending. These amounts are included in the categories of Major National Security and International Affairs and Finance.

Although the bulk of the rise in the fiscal '62 budget outlays shows up in defense and foreign aid, widespread increases also have been budgeted for domestic spending programs. The

Federal Budget Expenditures by Major Functions
Fiscal Year 1962
(In Millions of Dollars)

	Fiscal '62 Proposed	Change from Fiscal '61 Estimated	Change from Fiscal '60 Actual
Defense and International:			
Major National Security	$47,392	+1,462	+1,765
International Affairs & Finance	2,712	+ 402	+ 879
Total Defense	$50,104	+1,864	+2,644
"Benefits":			
Commerce, Housing & Space	3,371	− 413	+ 589
Labor & Welfare	4,759	+ 276	+ 340
Veterans Services & Benefits	5,296	+ 69	+ 236
Agriculture	5,101	+ 165	+ 268
Natural Resources	2,138	+ 187	+ 425
Total "Benefits"	$20,665	+ 284	+1,853
Other Nondefense Spending:			
Interest	8,593	− 400	− 673
General Government	2,071	+ 89	+ 376
Total Other	$10,664	− 311	− 297
Allowance for Contingencies	100	+ 75	+ 100
Adjust. for interfund trans.	− 667	+ 9	+ 27
Total Expenditures	$80,865	+1,920	+4,326

amount of these increases is obscured by the assumption that the Congress will accede to the renewed request for increased postage rates. If this is not done, outlays shown in the accompanying table under the heading of Commerce, Housing & Space would be raised by $843 million, thus turning the scheduled $413 million decline into a $430 million rise. Increases are general under this heading. Expenditures for the civil space program, only $145 million in fiscal '59, are rocketing up to almost a full billion dollars. New peaks of spending are also projected for promotion of aviation, community development, and public housing projects.

Outlays for Labor & Welfare programs would touch a new peak of $4.8 billion, according to budget proposals. Nearly half would be under the subhead of public assistance, which includes the new program of medical care for the aged passed by Congress last summer after a prolonged legislative battle.

Spending for Veterans Services & Benefits, at a low of $4.3 billion in fiscal '53 and '54 is budgeted to reach $5.3 billion in fiscal '62. Almost half of these benefits are not service-connected.

Outlays for Agriculture would rise to $5.1 billion, a new record except for fiscal '59. President Eisenhower warned that the "unrealistic price-support program" threatens to pile up even higher stocks of wheat, corn, and other grains. Federal spending for Natural Resources in fiscal '62 would move up to $2.1 billion, almost double the level of five years ago.

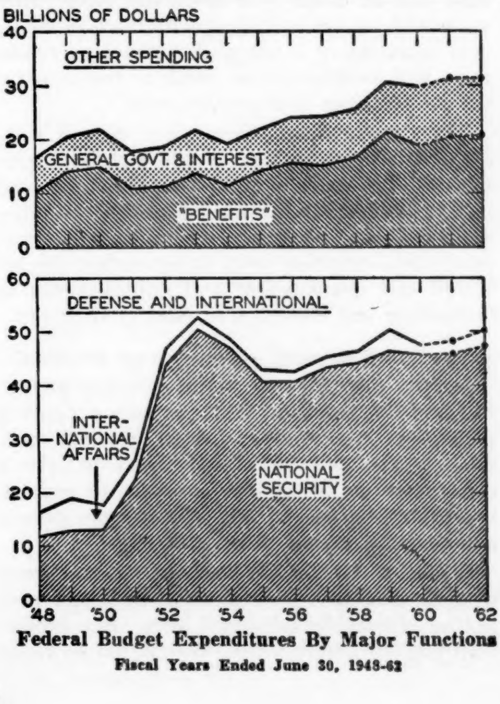
Interest payments on the public debt are slated for a $400 million decline to $8.6 billion in fiscal '62, reflecting easier conditions in the money market. The cost of General Government, including outlays for public buildings and the expense of tax collection, is expected to pass the $2 billion mark for the first time.

Public Poverty?

There is no confirmation in the federal budget record of the claim that is so often made that, while people are "affluent", the public (or governmental) sector of the economy is being "starved" for money. As the accompanying chart brings out, the most striking acceleration in federal spending since Korea (1951-53) has been in "Benefits," considered as governmental services flowing to the public under the functions of Commerce, Housing & Space, Agriculture, Labor & Welfare, Natural Resources, and Veterans Services & Benefits. Since fiscal '54, budget outlays for "Benefits" have climbed 78 per cent, twice as fast as the gross national product. Over these years, "Benefits" have expanded from 17 per cent of the total budget to 26 per cent at present.

This drift — pursued into the indefinite future — can redistribute wealth and income in favor of so-called underprivileged groups, but it does so at the expense of reducing incentives to work and at the further expense of loading more taxes onto the shoulders of workers and impeding capital accumulation for progress.

The nation discovered in the 1958 recession how easy it is, given a year's time, to lift federal



Federal Budget Expenditures By Major Functions
Fiscal Years Ended June 30, 1948-62

spending $10 billion or so. We also discovered — out of the "sluggishness" of the 1959-60 economy — that public munificence is not the road to full-fledged prosperity. Progress takes more than money. It takes eagerness among people to earn their livelihood. It is to be hoped that the new Administration, in framing its fiscal plans, will see the need for getting down to fundamentals and encourage individual self-reliance and forward-looking enterprise.

The Sixties—Problems and Potentials

Last month marked the start of a new decade — according to scholars who note that ever since the year 1 A.D. the first year of each decade has ended in 1 and the last in 0. Whether one agrees with this viewpoint or not, it provides a convenient occasion for a sober second look at the glowing promises so widely made for the Sixties a year ago. As a result of the disappointments during 1960, some observers are inclined to dub what were supposed to be the "Sizzling Sixties" as the "Fizzling Sixties."

Yet, it is just as much a mistake now to disregard the growth potential of the Sixties as it was a year ago to accept uncritically the notion that ten years of uninterrupted prosperity lay ahead. The potential for expansion is still there, but the past year's developments have put it in better perspective. Along with brilliant prospects, the Sixties have inherited serious problems and no doubt will breed still more. How successful we are in dealing with these problems — in maintaining a peaceful, prosperous economy — will determine how much of the potential we can translate into performance.

The decade ahead, even when viewed without rose-colored glasses, is still rich in opportunities. The main sources of expansion counted on for the years ahead are population growth — more people as consumers and more workers as producers — together with rising outlays for research and development and improvements in technology and efficiency to raise productivity.

Population Growth — Soaring or Slowing?

Nearly every forecast of the "Soaring Sixties" featured the argument that a rapidly expanding population would mean bigger markets and, thus, greater prosperity. We need to take a closer look at the figures, and also to recheck the basic assumption that adding more people automatically means more prosperity.

It used to be thought that population figures were the easiest of all to forecast, by simple projection of established trend lines. But projections put out before World War II fell seriously short of the mark, as Americans began to marry earlier and have more babies. In 1958, when the Bureau of the Census put out a set of four illustrative projections of the population, many forecasters thought that Series I, which showed the sharpest rise, would come closest to actual results. This projection, which assumed an increase in the birth rate, anticipated a population increase of 38.3 million persons, or 21 per cent, between July 1, 1960 and July 1, 1970. A rise of this magnitude — like adding five New York Cities, eleven Chicagos, or a hundred Louisvilles — provided the basis for much of the optimism about the markets of the Sixties.

Since 1957, however, the birth rate, instead of rising, has declined. The official Census estimate of the population on July 1, 1960 is 179.9 million (excluding Alaska and Hawaii which were not covered by the 1958 projections). Series I was already 1.2 million too high. The projection that was most nearly right for the 1957-60 period was Series III, which assumed that the birth rate would decline. On this basis, the population increase during the Sixties is estimated at 28.3 million persons, about 10 million fewer than the higher projection and scarcely larger than the 28.2 million persons added in the Fifties. The percentage rate of growth would actually shrink from the average of 1.7 per cent a year for the Fifties to 1.5 per cent a year in the Sixties. The economic gains of the Fifties were impressive, and may well be matched in the Sixties. But it will be hard to justify anticipations of accelerating economic expansion on the basis of population totals alone.

The War Babies Grow Up

As a matter of fact, the speeding of population growth since World War II has had effects of holding back increases in per capita production and consumption. As any parent knows, more children mean more expenses and personal sacrifices. It is only after a lapse of years that faster population growth translates itself into an enlarged working force.

The wave started by increased births in 1947 hit the elementary schools as 6-year olds in 1953. This year, as 14-year olds, they are beginning to flood the high schools. Nearly 4 million are reaching age 14 this year in contrast with less than 3 million last year. Since youngsters in their teens are capable of part-time work they may add to the unemployment rolls next summer as many of them look for work between terms. By 1965, they will be 18-year olds, surging into the colleges, the market for steady jobs, and the marriage license bureaus.

What to do to keep teenagers usefully active is a present-day problem. A strong social objection to the much-discussed increase in the $1 an hour minimum wage is that it will reduce opportunities for youngsters to learn something about what it is like to make a living and contribute to the national production. Work itself is a part of education.

A baby is a consumer from the day he is born; his demands become greater from day to day, from year to year. The increased numbers of babies born each year since 1947 have caused continuing shifts in consumer markets. The surge of demand that was felt by baby food manufacturers in the late Forties and by toy makers in the Fifties is currently being enjoyed by manufacturers of teen-age clothing, food, phonograph records, publishers of high-school textbooks, and so on. More money has been spent on schools and schooling in the past ten years than in the entire previous history of the United States.

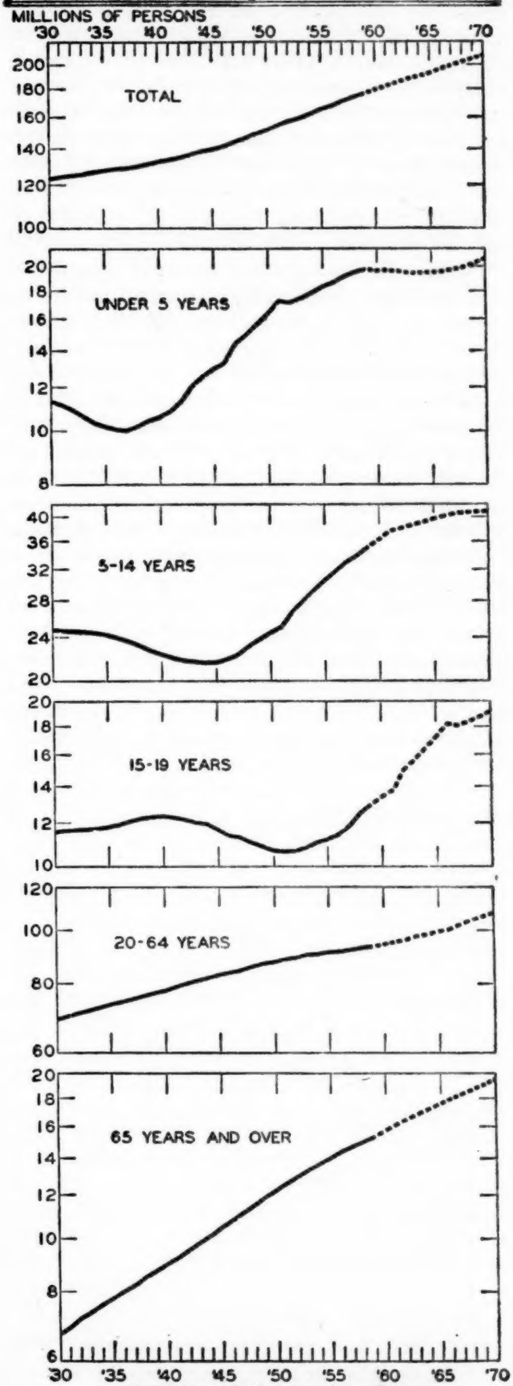
As the population wave reaches each new age group, it represents a shift to sustained higher levels of demand in a succession of lines. Still lying well ahead is the spurt in family formation. Increased marriages are to be expected in the latter part of the decade and on into the Seventies, producing initial needs for small apartments and furniture, not to mention a new cycle of demand for baby food. But the impact on building of single-family, owner-occupied homes may not be fully felt until the mid-Seventies.

A most dramatic feature of the chart, not to be overlooked, is the increase in the population 65 years and over. The steep rise from 6.7 million in 1930 to 19.5 million as projected for 1970 reflects the trend toward prolongation of human life with the advances in medical science.

Changes in the Labor Force

The test for our economic system in the late Sixties will be to integrate new workers into the labor force to meet growing demand for goods and services. We may then face an unusual shortage of seasoned manpower; in the 1965-70 period most of the new workers will be young and inexperienced at the same time that the number of experienced workers aged 30 to 40 will actually be declining – a heritage of the lagging rate of marriages and births during the Great Depression. During the past five years, we have had an average increase in the labor force of about 700,000 a year, but have had trouble keeping unemployment down within tolerable limits. By 1965-70, new jobs will have to be provided for twice that many each year.

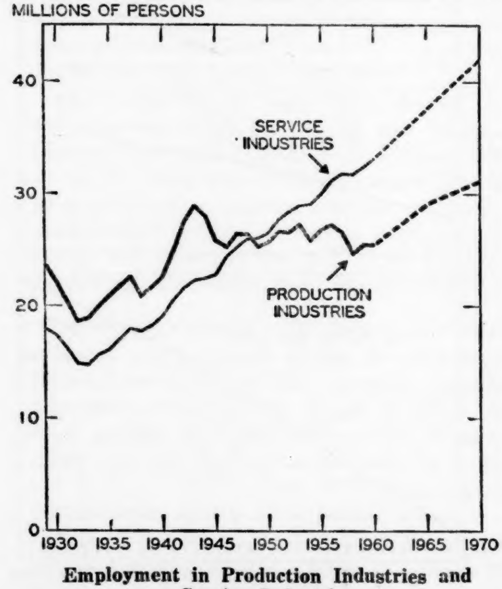
On the other hand, added workers mean added production. To the extent that jobs are found for these new workers (without reducing average productivity or working hours) over-all output



Total Population by Age Groups
Ratio scale used to show relative growth rates.
Source: U.S. Department of Commerce, 1930-59, actual; 1960-70, projected (Series III).

will grow. Per capita output should increase even faster, as the number of workers grows faster than their dependents. In the Fifties, persons entering the labor force were drawn largely from the "hollow generation" of the depressed Thirties; the number of workers rose 13 per cent from 1950 to 1960, while all others — the dependent population — increased 23 per cent. In the Sixties, projections by the U.S. Bureau of Labor Statistics indicate an increase in the labor force of nearly 14 million, or 19 per cent, but a rise of only 14 per cent in the number of dependents.

During the Sixties, the number of jobs available may have to expand by about 14 million to absorb all these new workers and keep unemployment down to 4 per cent of the labor force. Add to that several million new jobs needed for workers shifting out of industries where employment opportunities are shrinking. The swing from employment in production of goods (including manufacturing, mining, construction, and agriculture) to employment in service industries (including transportation, utilities, trade, finance, and government) has been a striking feature of the postwar period. As the accompanying chart shows, the U.S. Bureau of Labor Statistics expects these trends to continue during the Sixties. Twenty years ago employment in goods output was about one sixth greater than in service industries. By 1950 the two groups were about even and in 1960 service employment was definitely higher; projections indicate that in 1970 service employes will number 35 per cent more than production employes.



Employment in Production Industries and Service Industries

Source: U.S. Bureau of Labor Statistics; 1929-60 actual, 1965 and 1970 projected.

Products of Research

The steady outpouring of new products is evidence of a new force emerging in American industry — the increased emphasis on research and development. Yankee ingenuity has long been a feature of the American economic system. The difference today lies in the magnitude of the effort and the systematic approach to research.

Total outlays for research and development, according to a McGraw-Hill analysis, rose from $3.4 billion in 1950 to more than $12 billion in 1960 and are figured to exceed $22 billion by 1969. Industrial research, including that financed by government, has quadrupled in the past decade, totaling $9.6 billion in 1960, and is scheduled to reach $10.7 billion in 1963 and an estimated $16.5 billion in 1969.

In developing a new product, there is an average time lag of four to six years from the start of research to availability of a marketable product. Thus, for some time to come, the economy will be benefiting from the $50 billion-plus of research and development work done in the past five years, while much research now under way may not pay off until the mid-Sixties. Just how research will change the shape of the Sixties is impossible to foretell, but a glimpse of the vast potential is afforded by looking at just a few of the accomplishments of the Fifties. Ten years ago, the world had not yet seen earth satellites, jet airliners, electric power from an atomic reactor, or Salk vaccine; commercial applications of transistors and electronic computers had only begun, and the word "automation" was just coming into popular use.

Research and development acts as a force for growth in three ways: (1) creation of new products, (2) development of new processes and techniques to cut costs, improve quality, and otherwise broaden markets, and (3) encouragement of large-scale investment to put (1) and (2) into effect.

The Need for Investment

Investment is essential for real growth. A rising population does not automatically insure growth; on the contrary, if output fails to keep pace with the increase in population the result is a lowering of living standards as measured by the amount of goods and services available per capita. Research makes faster growth possible but does not guarantee it. Increased productivity — the ability to get more done per hour of human effort — is the central key.

Productivity increases can come from greater worker skill and effort, from better managerial

efficiency, improved technology, and — most important of all — from capital investment in modern machinery and equipment. The need for capital investment in the decade ahead will be tremendous. Just to maintain average output per man-hour at present levels requires heavy outlays for modernization and replacement of outworn equipment and for the tools and machinery to back up each of the millions of new workers joining the labor force. On top of this come all the needs for expansion and cost cutting.

How fast output will grow in the Sixties depends on three main factors: the number of workers, how long they work, and how much productivity rises. It is possible to estimate logically that the labor force will increase nearly 20 per cent during the Sixties. One can only guess how much individuals will prefer greater leisure to increased real income and living standards. The long-term trend has been, of course, toward shorter workweeks, longer vacations, more holidays, and coffee breaks; yet if concern over growth is as deep as professed during the election campaign, people may have to work harder and more efficiently — if not longer. The rate at which productivity will rise is the biggest question mark of all; it fluctuates from year to year and decade to decade. A rise in productivity at an average rate of 3 per cent a year instead of the historical average of 2 per cent could make a difference of over $50 billion in gross national product by 1970 — about $250 per person in that year and a total of $1,600 in the course of the decade.

Because these factors can vary so widely, projections for gross national product in 1970 published in the past couple of years range all the way from $630 billion to $837 billion. The potential for growth is substantial; how much of this potential is realized depends on our success in coping with some basic problems.

Problems of the Sixties

The magnitude of this nation's growth in the Sixties hangs on many unpredictable factors, not the least of which are world peace and the ability of the Free World to sustain prosperity. A more immediate concern, however, is the manner in which we deal during the Sixties with problems inherited from the Fifties. The consequences of doing the wrong things or failing to do the right things in past years will plague us in years ahead.

Outstanding among the heritages from recent decades is the problem of inflation. The growing acceptance of creeping inflation which developed during the late Fifties was not entirely reversed during 1960, although many of the adjustments which occurred last year were attributed to "liquidation of inflationary psychology" — to the conformation of business practices and consumer expectations to a situation in which prices are not rising steadily.

In the Fifties, there was too much toleration of employment cost inflation and the resultant price increases. Market resistance to these practices has been rising, and the balance-of-payments problem has brought into sharp focus the need to keep our industry lean and competitive. Meanwhile the persistent upward pressure of costs — even when competition puts a lid on prices — produces a squeeze on profit margins that limits plowback of profits for capital investment and growth.

Underlying the whole set of problems carried forward from the Fifties has been the toleration of labor monopoly and the changed attitude toward distribution of productivity gains. At one time the prevailing view was that the national welfare is best served when the fruits of productivity are split three ways: to labor in higher wages as a direct share; to stockholders as a stimulus to needed saving and investment; and to consumers, through lower prices, as a means of spreading the benefits throughout the economy. But money wage increases have regularly exceeded gains in man-hour output. Indeed, labor has sought for itself not merely all the gains of productivity, but even more.

The point at which these problems bear most closely on the question of growth in the Sixties is in maintaining a favorable climate for investment. Investment decisions are a distillation of a wide range of considerations, including the general soundness of the economy, the effect of our tax system on incentive, changes in technology, and the prospects of profits adequate to encourage investment. The level of expenditures on plant and equipment generated by these decisions will go a long way toward determining our ability to provide jobs for the growing labor force, the impetus given to improvements in productivity, and the over-all rate of growth.

Although the experience of the past year has taken some of the glow off the "Soaring Sixties", it should not obscure the true potential for substantial economic gains by 1970. What we see more clearly than a year ago are the pitfalls and problems along the way. Growth cannot be taken for granted; it is a challenge as well as an opportunity.

The 1960 index for this *Letter* is now available without charge. Address requests to our Public Relations Department, 55 Wall Street, New York 15, New York.

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